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OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The Costs and Benefits of Trade Facilitation

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Introduction

Steady increases in trade volumes and complexity in recent years have significantly changed the operating environment for the international trading community. They have also highlighted the negative impact of inefficient border procedures on governments, businesses and ultimately on the customer and the economy as a whole. Governments may face smuggling, fraud and national security problems, which drain the public coffers, while businesses pay the price of slow and unpredictable goods delivery, costly customs procedures, and even lost business opportunities. And all these costs ultimately make goods more expensive for the consumer.

These "hidden" costs of trade are so high – as much as 15% of the value of the goods traded in some cases – that studies show that for many countries, the welfare benefits for from more efficient customs procedures could be as high as those from reducing tariffs.

This is a problem for all trading nations, and finding ways to make the whole process of trading simpler and smoother – trade facilitation – is a key element of the Doha Development Agenda (DDA) for multilateral trade negotiations at the World Trade Organization.

Trade facilitation is particularly important for developing countries, as studies show they stand to gain the most from more efficient trade procedures, although achieving it may be more challenging for these economies than for the developed world. But even modest reductions in the cost of trade transactions would have a positive impact on trade for both the developed and the developing world.

This *Policy Brief* looks at the benefits that can be generated by trade facilitation, as well as the costs and challenges of achieving it, so as to make sure that countries can fully reap the gains of further multilateral trade liberalisation. ■

Observer oecd

What is trade facilitation?

Trade facilitation covers all the steps that can be taken to smooth and facilitate the flow of trade. The term has been used widely to cover all sorts of non-tariff barriers, including product testing and impediments to labour mobility, but in the WTO it is defined as "the simplification and harmonisation of international trade procedures" covering the "activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade".

The Doha Round talks on trade facilitation cover freedom of transit, fees and formalities related to importing and exporting and transparency of trade regulations – which essentially relates to border procedures such as customs and port procedures, and transport formalities. ■

Why does it matter?

International trade has grown rapidly in recent years, thanks to the progressive reduction of tariffs and quotas through successive rounds of multilateral trade liberalisation. More trade means more goods crossing borders and having to comply with Customs formalities. This has often put strain on national administrations trying to cope with the increased traffic without extra resources. At the same time, businesses have become more aware of the costs involved in taking goods across borders, such as waiting time.

Changing business practices have also put the spotlight on speed of delivery. In an environment of "just-in-time" production, where car manufacturers, for example, rely on the uninterrupted reception of the necessary components, business cannot afford to have imported or exported goods tied up for long periods at the border because of unnecessary or over-complicated trade procedures and requirements.

There is also the question of costs inherent in the increased complexity of trade. Globalisation and international competition encourage international corporations to use a variety of locations for the manufacture and sourcing of components and final products. Preferential trade agreements have added a proliferation of complex rules of origin to the mix.

In these circumstances, even methods that used to be satisfactory need to be rethought, while problems posed by inefficient methods are made worse. And inefficiency in border procedures, whether too few customs officers or unnecessarily complicated paperwork, is costly, both for governments and business – costs which ultimately are passed on to the taxpayer or the customer.

Businesses suffer both direct border-related costs, such as expenses related to supplying information and documents to the relevant authority, and indirect costs, such as those arising from procedural delays, lost business opportunities and lack of predictability in the regulations. Surveys aimed at calculating these costs suggest that they may range from 2% to 15% of the value of traded goods.

Inefficient border procedures cost ***governments*** in terms of lost revenue, smuggling and difficulties in implementing trade policy, for instance because of failure in determining the origin of products or in collecting accurate statistics.

Inefficient border procedures are also likely to lead to poor export competitiveness and make the country involved less attractive to investment. But taking action to improve the efficiency of border procedures has been shown to produce results. Countries that have carried out reforms in this area have achieved a substantial increase in Customs revenue, despite the reduction in duties brought by trade liberalisation. ■

What are the benefits of trade facilitation?

Essentially, everyone stands to gain from making the process of trade easier. Governments gain because efficient border procedures make them able to process more goods and improve control of fraud, thus increasing government revenue. Businesses gain because if they can deliver goods more quickly to their customers they are more competitive. And consumers gain because they are not paying the costs of lengthy border delays. If a truck waits at the border for a week, ultimately the customer is paying for its being off the road and unproductive during that time.

Studies indicate that even modest reductions in trade transaction costs, such as lengthy border procedures, translate into significantly increased trade. This is true for both rich and poor countries, but developing countries would show higher relative trade gains because of the relative inefficiency of their current systems and because agrofood and small and medium enterprise (SME) trade, which are most severely affected by inefficient procedures are central for the economy of these countries. Taking into account how trade facilitation measures to reduce transaction costs affect different sectors of the economy and different types of traders, OECD research shows that developing countries stand to gain two thirds of total world welfare benefits from trade facilitation. But if trade facilitation were to be undertaken by OECD countries alone, developing countries would stand to lose.

Table 1.

SCENARIO RESULTS ON INCOME EFFECTS OF ONE PER CENT REDUCTION OF TRADE TRANSACTION COSTS (MILLION USD AND PER CENT OF TOTAL)

	Country diversity	Country and sector diversity	Country, sector and trader diversity	OECD only
Worldwide income gains	41 844	42 247	43 259	14 053
– due to direct cost reduction	7 689	8 119	8 250	2 650
– due to indirect cost reduction	34 155	34 128	35 009	11 402
OECD	37%	37%	35%	103%
OECD Asia-Pacific	7%	7%	7%	22%
OECD Europe	17%	17%	17%	45%
OECD North America	13%	12%	11%	36%
Non-OECD	63%	63%	65%	-3%
Former Soviet Union	7%	7%	7%	-1%
Middle East and North Africa	11%	11%	11%	0%
Latin America and Caribbean	13%	13%	13%	-1%
Non-OECD Asia-Pacific	24%	24%	24%	-1%
Sub-Saharan Africa	7%	7%	7%	0%
Rest of world	1%	1%	1%	0%

Source: OECD Secretariat.

In many developing countries, clearance times for exports and imports considerably affect the competitiveness of national industry. Indian companies suffer an estimated 37% cost disadvantage in shipping clothing from Mumbai to the United States compared with Shanghai purely as a result of delays and inefficiencies in Indian ports; while Fiji holds its own against low-cost competitors because of its ability to provide quick deliveries of high-quality garments.

Table 2.

TRANSIT, FREIGHT AND DUTY COST ON US IMPORTS OF TEXTILES AND CLOTHING (%)

Country of origin	Time factor 0.5%/day*	Freight cost*	Customs duty*	Total cost*	Relative to China*
Mexico					
Two-way shipment	2.0	1.2	0.0	3.2	20.9
One-way shipment	1.0	0.6	0.0	1.6	22.5
Canada					
Two-way shipment	2.0	1.8	0.0	3.8	20.3
One-way shipment	1.0	0.9	0.0	1.9	22.2
Dominican Republic					
Two-way shipment	5.0	3.4	0.0	8.4	15.7
MFN shipment	2.5	1.7	12.3	16.5	7.6
Colombia					
Two-way shipment	9.5	3.4	0.0	12.9	11.2
MFN shipment	5.0	1.7	12.3	19.0	5.1
China					
MFN shipment by sea	6.0	5.8	12.3	24.1	–
MFN shipment by air	1.0	14.5	12.3	27.8	–
South Africa					
Two-way shipment	29.5	10.0	0.0	39.5	-15.4
MFN shipment	12.5	5.0	12.3	29.8	-5.7
Kenya					
Two-way shipment	61.5	9.8	0.0	71.3	-47.2
One-way shipment	30.5	4.9	0.0	35.4	-11.3
MFN shipment	30.5	4.9	12.3	47.7	-23.6

* In per cent of import value.

Source: OECD.

Improved border procedures also have a knock-on effect on other areas of the economy. Countries that are competitive in trade terms find it easier to attract foreign direct investment, for example.

Trade facilitation also brings more efficient and reliable tax collection, a particularly important consideration for developing country governments that depend on trade taxes to finance their public administrations. Cote d'Ivoire, Lesotho and Madagascar, for example, all rely on trade taxes for more than a third of government revenue. Indeed, the prospect of increased revenue is one of the main incentives to reform. Revenue loss from inefficient border procedures has been estimated at more than 5% of GDP in some cases. ■

What are the costs?

If the benefits are so evident, why are some countries reticent to commit to trade facilitation in multilateral negotiations? One reason is that for developing countries in particular, improving an inefficient customs system may place multiple demands on limited resources. Another is that governments will have to fund some of the reforms before they see any benefit in terms of increased revenue and trade, although initial benefits can then be used to pursue further reform.

A particular cause for concern is the fact that it is difficult to say how much effective trade facilitation would cost, or how much reform governments would have to undertake before they started reaping the benefit.

Governments generally do not undertake trade facilitation by itself; it is mostly part of a wider reform effort, often driven by elements such as the transition to a market economy or accession to a regional grouping or trade agreement. As a result there is often no specific allocation of funding to trade facilitation per se, making it all the more difficult to assess specific costs. However, although customs reforms will be more complex in countries with the least efficient systems, even modest improvements will bring considerable relative gains.

Costs incurred in introducing trade facilitation measures basically involve introducing new regulations; institutional changes; training; equipment; and infrastructure.

Regulatory costs arise because trade facilitation measures may require new legislation or amendments to existing laws, requiring time and staff specialized in regulatory work. But reforms that do not require legislative changes mostly seem to be handled at the operational level and thus entail little additional cost.

Institutional costs arise because some trade facilitation measures require setting up new units, such as a risk management team or a central enquiry point, which may require additional staff. This involves cost even if existing staff are redeployed, mainly because of training requirements.

Training is probably the most important element of trade facilitation since the whole process is primarily about changing border agencies' ways of doing business. Countries may choose to recruit new expert staff, train existing staff or import trained staff through exchanges with other ministries and agencies. Recruiting new expert staff is the most costly option. Most countries that have undertaken reforms have chosen to train existing staff on the job. Although the financial costs are lower, this will be a lengthy process as staff need to simultaneously perform their normal duties.

Equipment and infrastructure are often the most costly elements although their role in trade facilitation should not be overstated. Most equipment and infrastructure should be viewed as implementation tools that should be carefully combined and sequenced with regulatory, institutional or human resource changes. Information and communication technology may help improve efficiency and effectiveness, for example, but will not produce trade facilitation unless burdensome red tape is simplified before the system is automated. At the same time, insufficient equipment and infrastructure make some facilitation measures such as pre-arrival processing or risk management more difficult to implement.

Evidence available to date suggests that these costs are more than offset by staff savings at the border and by enhanced control and revenue collection. Most developing countries that have taken the plunge have seen the benefits exceed the costs, in many cases by a very wide margin. By the time it was mid-way through a five-year customs modernisation programme, Angola had increased revenue by 150% and reduced customs procedures to 24 hours. ■

How is trade facilitation achieved?

Making the nuts and bolts of trading procedure easier to navigate requires transparency in the regulations and procedures, and consistency, predictability and non-discrimination in their application. Traders also need to be able to provide feedback on where the system works well and where it poses them problems.

Transparency of relevant domestic regulations, procedures and practices is widely recognised as essential for ensuring that regulatory objectives are achieved efficiently while at the same time enhancing the benefits expected from trade and investment liberalisation. Businesses need to be able to fully understand the conditions and constraints for entering and operating in a market. Openness about the way the system works also improves public confidence in the government's performance and that of the regulatory system. Among transparency measures, internet publication, setting up enquiry points or issuing advance rulings will entail some inception and training costs but these are mostly counterbalanced by cost savings in other areas.

The notion of openness is a two-way street, and governments generally maintain formal consultative arrangements with stakeholders such as importers' associations, government agencies, and the trading community. Surveyed countries said that this required no extra cost since the involvement of stakeholders was already central to the operation of customs.

Consistency and predictability in the application of rules and procedures is also important. Traders need to know what to expect in their everyday dealings with Customs and other border agencies and how to act if a problem arises. The introduction of appeal procedures in the countries that do not already have them in place will entail some institutional costs and these are usually absorbed in the countries' court systems.

Simplifying border procedures is at the heart of trade facilitation. One method that helps reduce waiting time at the border is to allow traders and transporters to file the documentation for a shipment before it actually arrives at the border. This requires a certain degree of automation on the Customs side as the most efficient way to do this is online. Nonetheless, even the limited use of advance filing of documents has generated important savings in the number of staff engaged in processing documents and reduced border crossing times.

Another useful tool is risk assessment, a technique to assess and manage the risk that an individual shipment violates border controls. This allows Customs administrations to devote minimal attention to "low risk" travellers and shipments, allowing the re-deployment of Customs resources on intensified controls for travellers and shipments judged to represent a higher, or unknown, risk. Such systems also do away with unnecessary burdens on traders by downscaling physical inspection and reducing bottlenecks at border crossings. This is one of the most costly trade facilitation measures as it requires investment in infrastructure and specialist training. But it also produces significant benefits, not just in reducing the number of cargoes that need to be inspected, but also in speeding up the processing of advance documentation.

For governments, there is also the issue of co-operation between Customs authorities and other border agencies, such as sanitary, agriculture, or police authorities. In many countries although there is no formal framework to ensure inspections by different authorities are carried out at the same time, it does happen in practice. ■

Why involve the WTO?

The key advantages of achieving a WTO undertaking on trade facilitation would be renewed political impetus to make border controls more efficient and strengthened international coherence in tackling the issue. The need to enhance efficiency in order to face an increasingly complex international trading environment has been an important driving force behind national Customs reforms around the world in recent years. However, it has frequently not gone far enough to do away with deeply entrenched outdated institutional settings and cumbersome procedures. To be successful, a trade facilitation agenda needs wide political support and the sustained commitment of those involved in formulating and implementing trade policy. Trade facilitation rules in the framework of the WTO could offer this missing impetus at the multilateral level, providing an external discipline to ensure continuing domestic political commitment and shield from temptations to backtrack

Coherence is also essential. Trade facilitation efforts, national or international, need to be consistent between different policy areas. A coherent multilateral setting would provide a solid background for designing well targeted technical assistance and capacity building projects, overcoming regional divides, ensuring that the projects' different components are mutually supportive and better targeting aspects of co-operation between border agencies of concerned countries.

It should be borne in mind that possible commitments on trade facilitation are principally about working together towards the common goal of domestic and global efficiency and enhanced governance, rather than about countries making concessions as is the case with many WTO negotiations. So the focus would be on benchmarking, capacity building and peer pressure to provide momentum, diluting the prospect of litigation under the dispute settlement mechanism.

To act as a driving force, such a multilateral effort needs to be challenging, but at the same time realistic. No external discipline or pressure can deliver tangible outcomes if the commitments go beyond the existing capacity of a particular country to meet them. Matching commitments with capacity means designing disciplines that correspond to the circumstances of member countries, and particularly developing countries. But matching commitments with capacity also means providing corresponding technical assistance where appropriate.

Multilateral disciplines on trade facilitation will ensure a broad level of predictability in border controls in all participating countries, simplifying trade for all participants. The prospect of this benefit should bolster the willingness of donor agencies and the private sector to provide technical assistance aimed at underwriting the implementation of related commitments. ■

For further information

For further information regarding this *Policy Brief*, please contact Evdokia Moïsé-Leeman, tel. +33 01 45 24 89 09, e-mail *evdokia.moise@oecd.org*. ■

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For further reading

These documents can be reached on the OECD Web site at *www.oecd.org/ech/tradepolicy/facilitation*.

- The economic impact of trade facilitation TD/TC/WP(2005)12/FINAL.
- The cost of introducing and implementing trade facilitation measures: Interim Report TD/TC/WP(2004)36/FINAL.
- The role of automation in trade facilitation TD/TC/WP(2003)21/FINAL.
- Trade Facilitation Reforms in the Service of Development TD/TC/WP(2003)11/FINAL.
- Quantitative Assessment of the Benefits of Trade Facilitation TD/TC/WP(2003)31/FINAL.

Where to contact us?

OECD HEADQUARTERS
2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: (33) 01 45 24 81 67
Fax: (33) 01 45 24 19 50
E-mail: sales@oecd.org
Internet: *www.oecd.org*

GERMANY
OECD Berlin Centre
Schumannstrasse 10
D-10117 BERLIN
Tel.: (49-30) 288 8353
Fax: (49-30) 288 83545
E-mail:
berlin.contact@oecd.org
Internet:
www.oecd.org/deutschland

JAPAN
OECD Tokyo Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0035
E-mail: center@oecdtokyo.org
Internet: *www.oecdtokyo.org*

MEXICO
OECD Mexico Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560 MEXICO, D.F.
Tel.: (00.52.55) 9138 6233
Fax: (00.52.55) 5280 0480
E-mail:
mexico.contact@oecd.org
Internet:
www.rtn.net.mx/ocde

UNITED STATES
OECD Washington Center
2001 L Street N.W., Suite 650
WASHINGTON DC. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: *www.oecdwash.org*
Toll free: (1-800) 456 6323

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